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MANUFACTURERS HANOVER

Financial Digest

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Analysis of Business Trends Plus Selected Financial Indicators

Twin Threats

It must be spring. Similar to the rapidly changing weather patterns which buffet large swaths of the country at this time of year, the financial markets have been recently roiled by a fast-flowing flood of contradictory economic statistics, some providing scattered evidence of a pick-up in business activity and a quickening of inflation, and others pointing in the opposite direction. Having said this, however, the April employment numbers cleared the air a bit, providing a strong hint that the economy is more lethargic than robust, and that a Federal Reserve firming of monetary policy is both unwarranted and inappropriate. But just while the danger of a Fed-engineered run-up in interest rates may have ebbed, there is a growing threat from another quarter. The adoption of stricter lending standards by commercial banks is thought to be touching off a new style credit crunch, and the end result might be the same as if monetary policy was aggressively tightened. This fear, too, is exaggerated, diminishing in direct proportion to the distance from recession-scarred New England.

While the longer-run implications of any monthly statistic are problematic at best, the monthly employment data are carefully scrutinized since they provide the framework for follow-up reports on personal income, industrial production and industry operating rates. And April was no exception, providing an initial glimpse of the economy's health in the current quarter. Contrary to expectations, the prognosis jolted the apocalyptic pundits who were assuring us that interest rates were on an elevator ride upward. According to the Labor Department, nonfarm payroll employment rose by an unexpectedly paltry 64,000 persons in April, a jobs gain which was in the plus column only because of a large bulge in temporary new hires by the Census Bureau. Weakness was widespread, with private sector payroll employment dropping for the second month in a row, something that hasn't happened in over seven years, factory employment declining again and the average workweek remaining unchanged. New factory jobs were so scarce, in fact, that the proportion of nonagricultural industries reporting a monthly gain in payroll employment slipped to one of its lowest levels since the 1981-82 recession.

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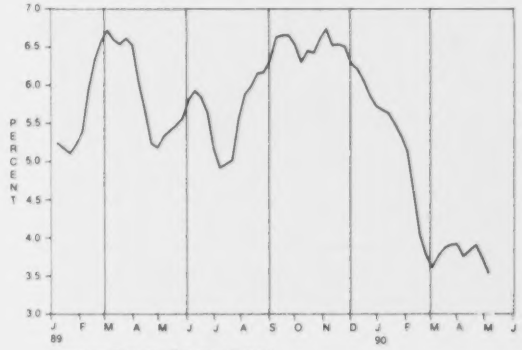
Inflation Subsides

In light of the relative dearth of generally higher paying goods-producing jobs, it was hardly surprising that wage pressures not only remained muted, but seemed to be subsiding. Since this is a key indicator of the proximity of the inflation threat, signs of a benign wage environment were just as pleasing to the financial markets as the weak employment numbers. For

C & I LOANS AT LARGE COMMERCIAL BANKS
(YEAR-OVER-YEAR PERCENT CHANGES)



Source: Federal Reserve Board

notwithstanding a better than 13 percent increase in the minimum hourly wage rate on April 1, average hourly earnings growth actually slowed last month, inching ahead by 0.3 percent month-over-month. This brought the 12-month change in earnings to 3½ percent, the slowest year-over-year increase since late 1988, and not far from average annual wage growth during the 1984-89 period.

Wage trends are not the only footprints of an ebbing inflation threat. With oil prices retreating, gold prices soft and commodity prices stabilizing, several good months of inflation news lie ahead. Nor is there much inflation in the so-called "pipeline". The 0.3 percent decrease in producer prices in April brought the rise in these prices to 3.5 percent during the past year. What is more, prices for intermediate goods were virtually unchanged over the past 12 months while prices for crude materials dropped by 1.5 percent. At retail, the clothing-price led bulge in the consumer price index is over for now, further brightening the inflation outlook. For these reasons, the likelihood of a tightening of the monetary screws, which only recently was being urged on the Federal Reserve, has receded.

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A Credit "Crunch" In The Works?

While the Fed may be disinclined to tighten credit anytime soon, the economy may not be completely out of the interest rate woods yet. This is because there is a growing fear that the commercial banks and regulators are doing the job for them—producing an unintended credit "crunch". The perceived crunch is a by-product of several factors. These include the implementation of tougher credit standards by commercial banks in the wake of hefty loan losses in the 1980s, a desire to limit bank asset growth in order to satisfy the stricter capital requirements of the 1990s, and heightened regulator vigilance, designed both to avoid a repetition of losses of the '80s and to comply with the rules of the '90s. Since this could coincide with rising credit demands due to a flattening of cash flow growth, the potential exists for a sharp downdraft in business spending for inventories, employment and capital equipment later this year.

For now, however, evidence of a crunch is regionally scattered, and largely anecdotal. Although the growth of commercial and industrial loans outstanding has slowed from a better than seven percent yearly clip in the latter part of 1989 to less than three percent currently (see chart), the implications of this are unclear. Banks have hardly turned off the credit tap, and most appear ready to respond positively to creditworthy new business. Credit demands may have simply shifted from the banks to the less expensive commercial paper market, where nonfinancial company outstandings have been rising by about $1¼ billion per week so far this year, and are up by more than 22 percent over the past year. Even real estate-related lending continues to grow. Real estate footings at the nation's commercial banks reached a record high of $367 billion in early May, up nearly 14 percent over the past 12 months. To be sure, the numbers mask wide regional disparities, ranging from strength on the West Coast to pronounced weakness in New England, but at this juncture the presumed credit crunch is not seriously restricting either the economy in general, or construction activity in particular.

Interest rate spreads are not signaling a credit crunch, either. The yield differential between corporate and Treasury debt has actually been narrowing since the turn of the year. It would be going the other way if the availability of business credit was tightening. As a result, while the prospect of a credit crunch cannot be dismissed, especially for small- and medium-sized firms, it doesn't seem to be here yet, judging by the debt totals and the relevant interest rate spreads. ■

Short Term Paper Outstanding
(Millions of Dollars)

Time Deposits $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/2/90)	214,306	+ 42	- 374
New York City (5/9/90)	39,486	- 355	- 3,085
Commercial Paper (5/9/90)	556,587	+ 5,313	+ 53,205

Bank Loans
(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/2/90)	326,990	+ 1,738	+ 9,092
New York City (5/9/90)	58,965	- 256	+ 364

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/2/90)	1,015,365	+ 7,789	+ 60,977
New York City (5/9/90	181,555	- 2,658	+ 8,966

Selected Federal Reserve Data
(Averages of Daily Figures—Billions of Dollars)

	Week Ending 5/16/90	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov't's and Agencies Owned Outright & RPs	232.313	+ 1.296	- 13.435
Loans to Depository Inst.	1.082	+ .215	- .652
Float	.680	+ .025	- .297
Total Reserve Bank Credit	274.190	+ .956	+ 4.501
Treasury Deposits with Federal Reserve Banks	5.037	+ .197	- 11.129
Currency in Circulation	262.218	+ .937	+16.511
Gov't's held for Foreign Acct. by F.R. Banks (End-of-Week)	223.637	+ .466	- 14.033
	5/16/90		
Member Bank Reserves:			
Total Reserves Held	59.285	- 1.378	+ 1.209
Excess (Deficiency)	.862	- .236	+ .003
Net Free Reserves	.559	- .283	+ .233
		‡ % Change Since 3 Months Ago*	Year Ago
Monetary Aggregates †			
M1 (5/7/90)	805.5	+ 5.9	+ 3.2
M2 (5/7/90)	3,271.6	+ 4.7	+ 6.0
M3 (5/7/90)	4,067.7	+ 1.9	+ 2.6
Domestic Nonfinancial Debt (4th Q'89)	9,790.0	+ 2.1	+ 8.1

† Seasonally adjusted. * Seasonally adjusted annual rate. ‡ Four-week moving average.

New York Money Market

Offering Rates 5/18/90	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	7.74%	7.73%	7.72%
* Federal Agencies	8.30	8.50	8.70
* Municipal Notes–High Grade (34% Taxable Equivalent)	9.47	9.47	9.47
Negotiable Time CDs			
Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	8.36	8.51	8.60

‡ Finance Company Paper–Prime		‡* Bankers' Acceptances	
5- 14 days	8.10%	Jun.	8.14%
15- 29 days	8.10	Jul.	8.12
30- 59 days	8.13	Aug.	8.12
60- 89 days	8.13	Sep.	8.21
90-179 days	8.12	Oct.	8.10
180-239 days	8.00	Nov.	8.08
240-270 days	8.00		

‡ Industrial Paper–Prime			
30- 89 days	8.18%	†Federal Funds	
90-120 days	8.15	Effective Rate	8.19%

‡ Discount basis. *Subject to availability. † Estimated.

Financial Markets

	Friday 5/18/90	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.98%	+ .12	- .66
180-Day Bills†	8.14	+ .11	- .69
Longest Bills†	8.30	+ .10	- .58
Recent Issues:			
8⅞s 4/30/92	8.60	+ .06	
8⅛s 3/30/94	8.71	+ .08	
8⅞s 5/15/00	8.74	+ .09	
8¼s 5/15/20	8.70	+ .06	
Municipals:			
Bond Buyer—20 Bond Index* (5/17/90)	7.29%	- .10	+ .11
Blue List Total ($ Million)	$ 964	- $ 11	- $ 83
30-Day Visible Supply ($ Million)	$2,477	+ $164	+$ 362
Total	$3,441	+ $153	+$ 279
Corporates:			
Moody's Aa Composite (5/17/90)	9.66	- .15	- .07
30-Day Visible Supply ($ Million)	$ 550	- $350	- $1,384
Stocks:			
Dow-Jones Averages:			
Industrials	2,819.91	+ 18.33	+318.81
Transportation	1,177.28	- .17	+ 20.91
Utilities	214.79	- 2.20	+ 14.28
65 Stocks	1,033.25	+ 1.73	+ 80.68
N.Y.S.E. Composite Index	193.52	+ 1.28	+ 14.60
N.Y.S.E. Avg. Daily Vol. for Week (000's)	170,651	+ 6,309	- 22,799

*34% Taxable equivalent 11.05%. † Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 5/18/90	Week Ago
Overnight	8.06%	8.13%
1 month	8.19	8.19
3 month	8.31	8.31
6 month	8.44	8.44
1 year	8.75	8.63

FOREIGN EXCHANGE SPOT RATES New York Opening (5/18/90)	Currency Per U.S. $	Week Ago
Belgium	34.14	33.77
Canada	1.1775	1.1784
France	5.5695	5.5125
Germany	1.6525	1.6310
Italy	1215.20	1203.50
Japan	152.80	152.90
Mexico	2788.00	2781.00
Netherlands	1.8568	1.8333
South Korea	701.10	699.41
Switzerland	1.3995	1.4060
Taiwan	27.19	26.20
U.K.*	1.6898	1.6820

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (5/18/90) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	+0.8%	-3.2%

Selected Business Indicators
(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	1st Q'90	$ 5,441	$ 5,340	$ 5,113
Gross National Product (1982 Dollars)*	1st Q'90	$ 4,196	$ 4,174	$ 4,107
Percent Change, Annual Rate	1st Q'90	2.1	1.1	3.7
Change in Consumer Prices*	Apr '90n	2.4 %	6.0%	8.4%
Change in MH Cost of Living Index*	Apr '90n	1.2 %	7.2%	6.0%
Change in Producer Prices*	Apr '90n	- 3.6 %	- 2.4%	7.2%
Civilian Employment (Thousands of Persons) †	Apr '90	118,116	118,334	117,084
Unemployment as % of Civilian Labor Force †	Apr '90	5.4%	5.2%	5.3%
Personal Income*	Mar '90	$ 4,670	$ 4,634	$ 4,361
Leading Indicators Composite Index (1967=100) †	Mar '90	145.2	143.9	144.7
Industrial Production Index (1977=100) †	Apr '90n	108.7	109.1r	108.6
Net Change in Consumer Installment Credit †	Mar '90n	$ 2.62	$ 0.06r	$ 5.60r
U.S. Merchandise Trade Balance †	Mar '90n	- $ 8.45	- $ 6.10r	- $ 8.92
Plant and Equipment Expenditures*	2nd Q'90	$ 509.1(a)	$ 502.7(a)	$ 470.9
Private Housing Starts (Thousands of Units)*	Apr '90n	1,245	1,321	1,341
New Construction Expenditures*	Mar '90	$ 432.5	$ 438.6	$ 416.8
Total Business Inventories †	Mar '90n	$ 794.0	$ 794.0r	$ 767.3r
Total Business Sales †	Mar '90n	$ 539.1	$ 535.9r	$ 512.8r

*Seasonally adjusted annual rate. † Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

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